Euro Area Stresses and Policies

Dublin Economics Workshop

October 13

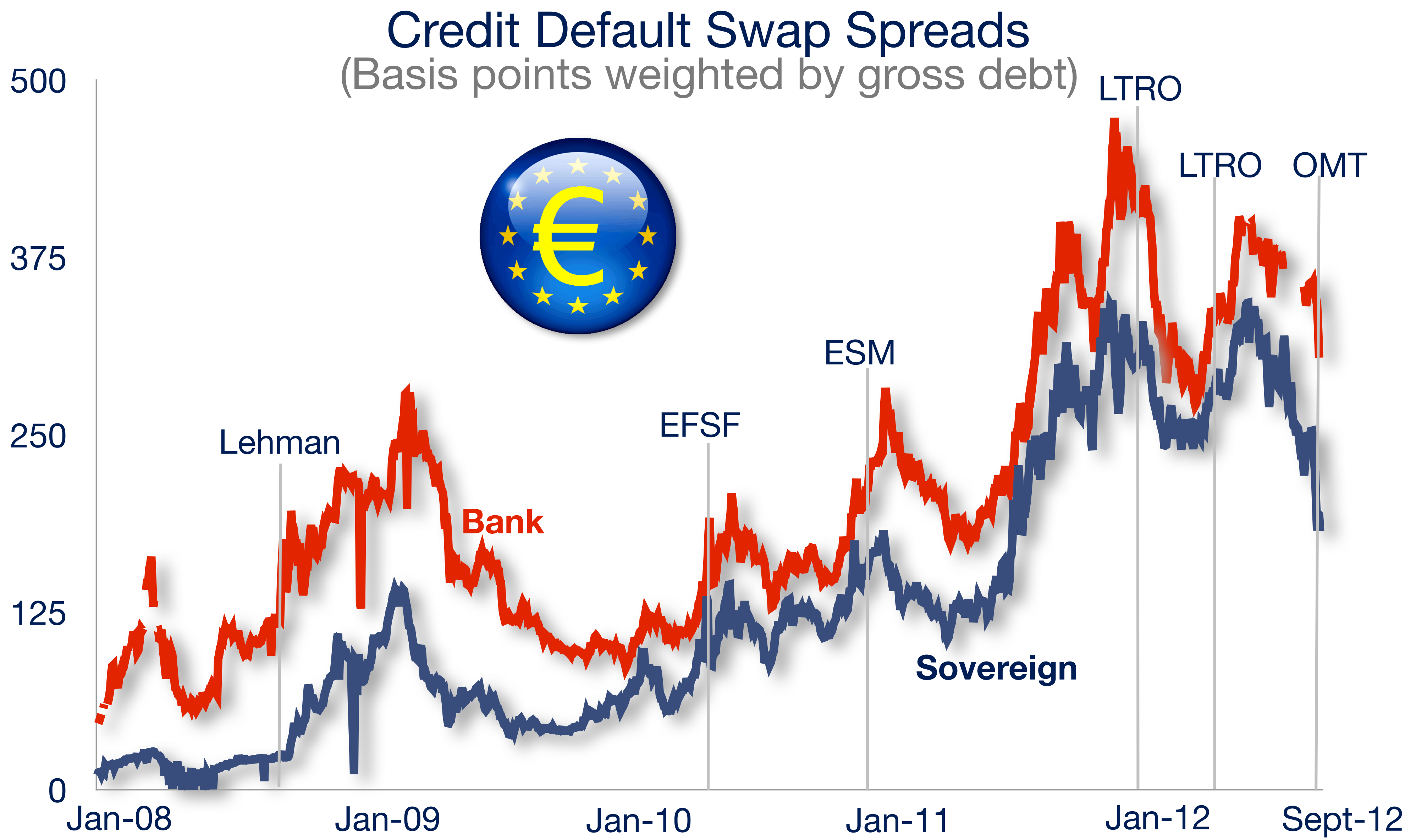
Peter Breuer

Outline

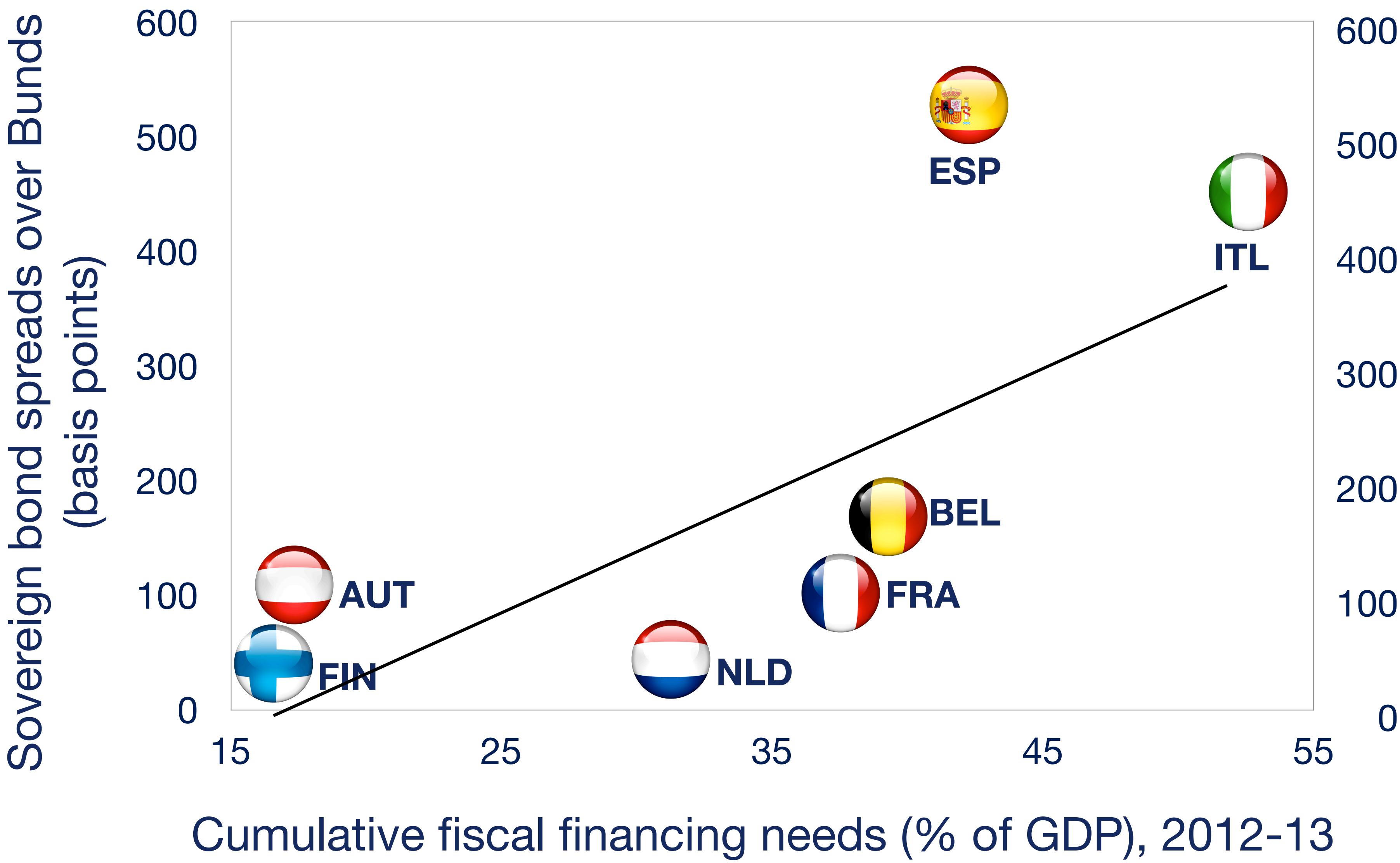
- Euro Area Stresses
- Euro Area Growth
- Euro Area Policies
    - Architecture
    - Short-run Demand
    - Structural

Euro Area Stresses

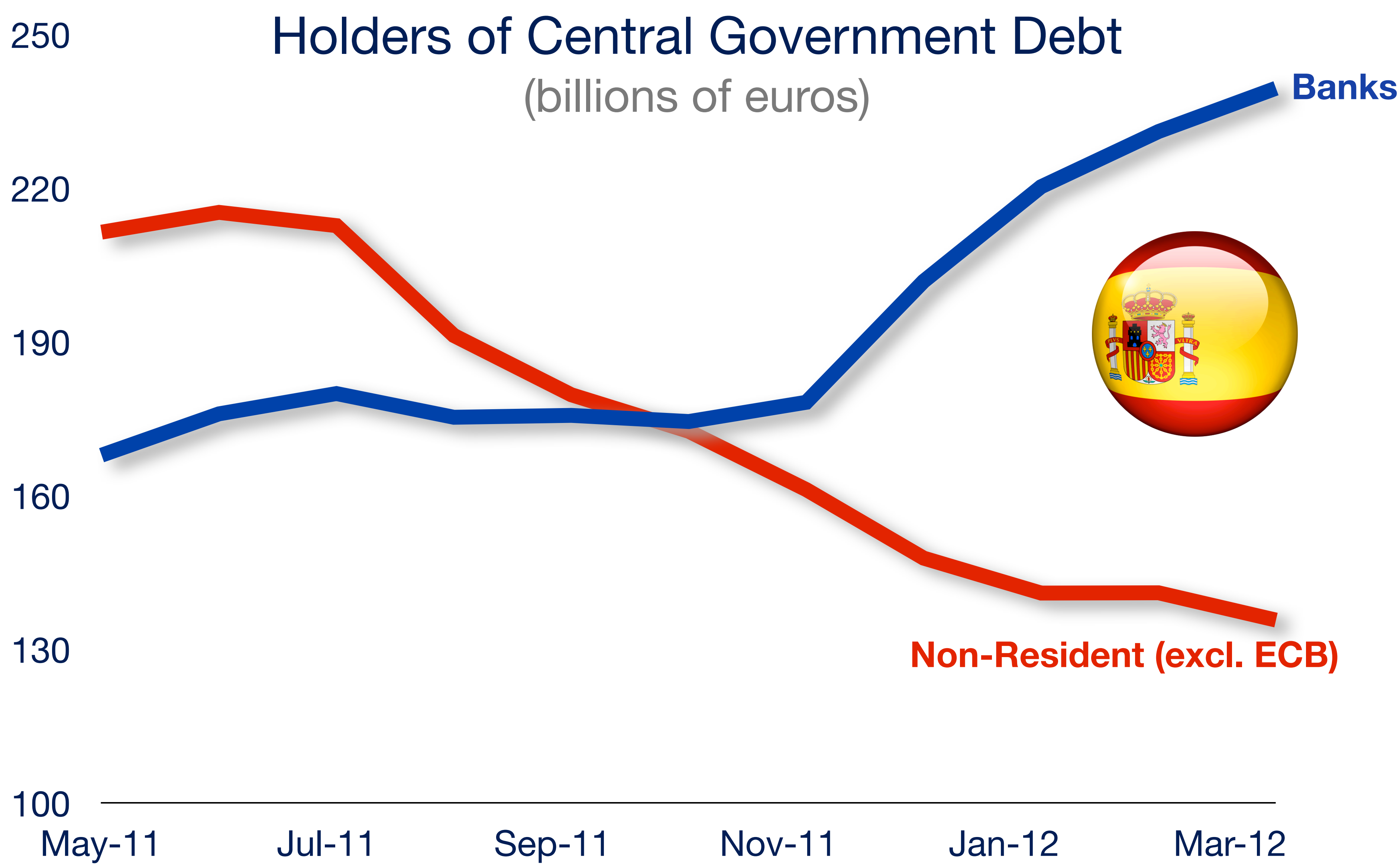
Stress Remains Elevated



Financing Needs Increase Stress



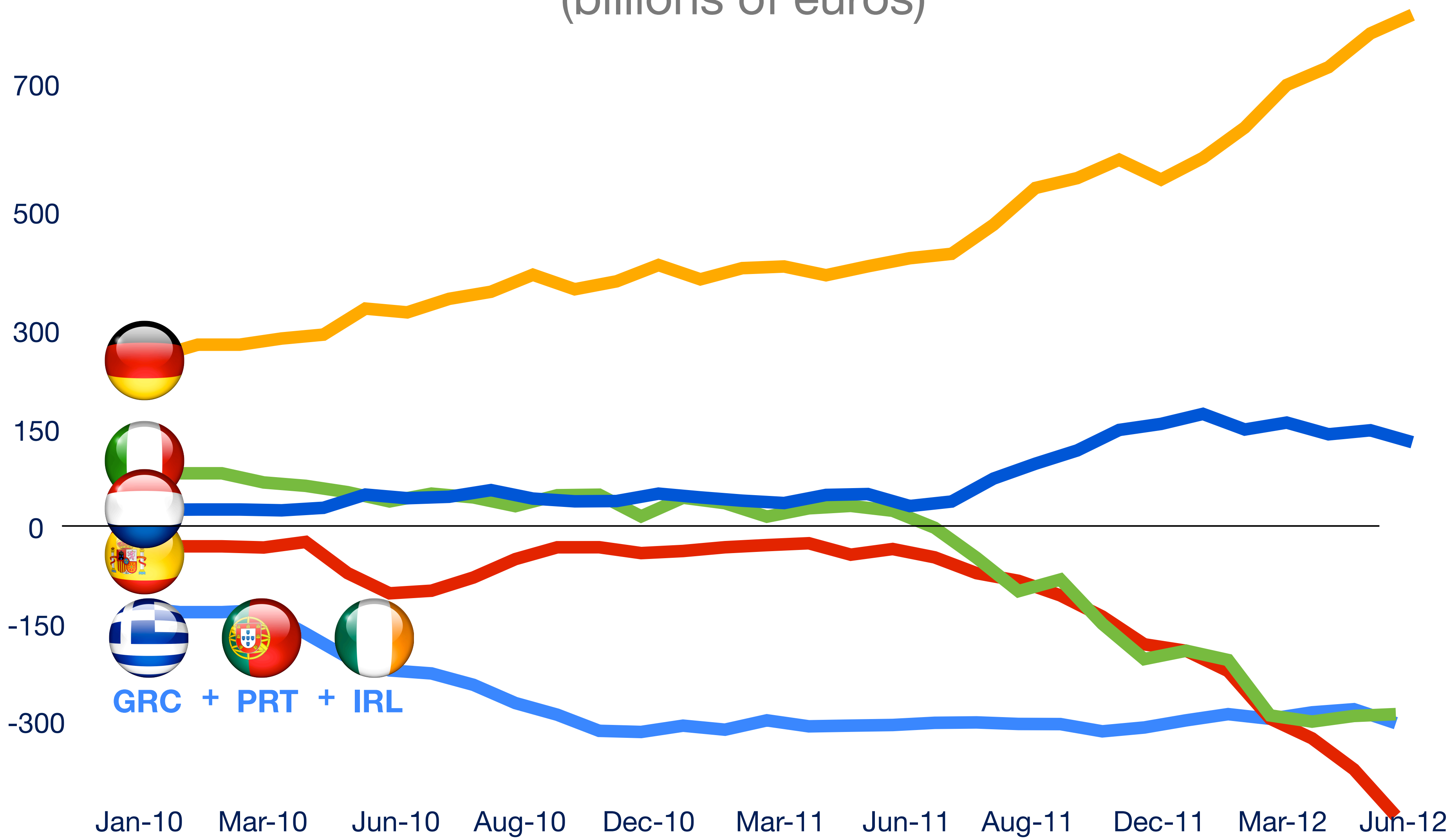
Sovereign Bank Links Intensify



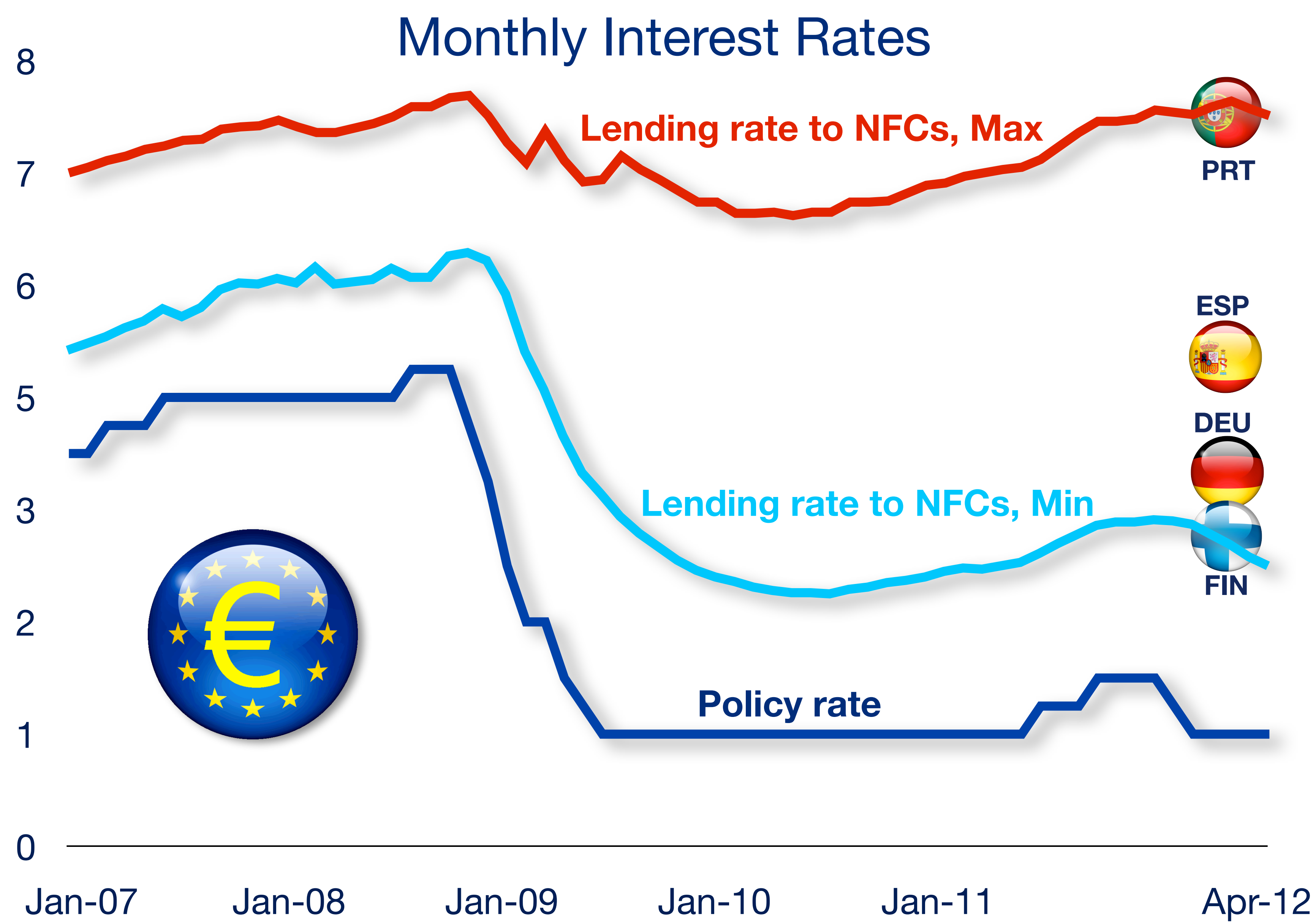
Public Replacing Private Funding

Net Balance with The Eurosystem (Target 2)

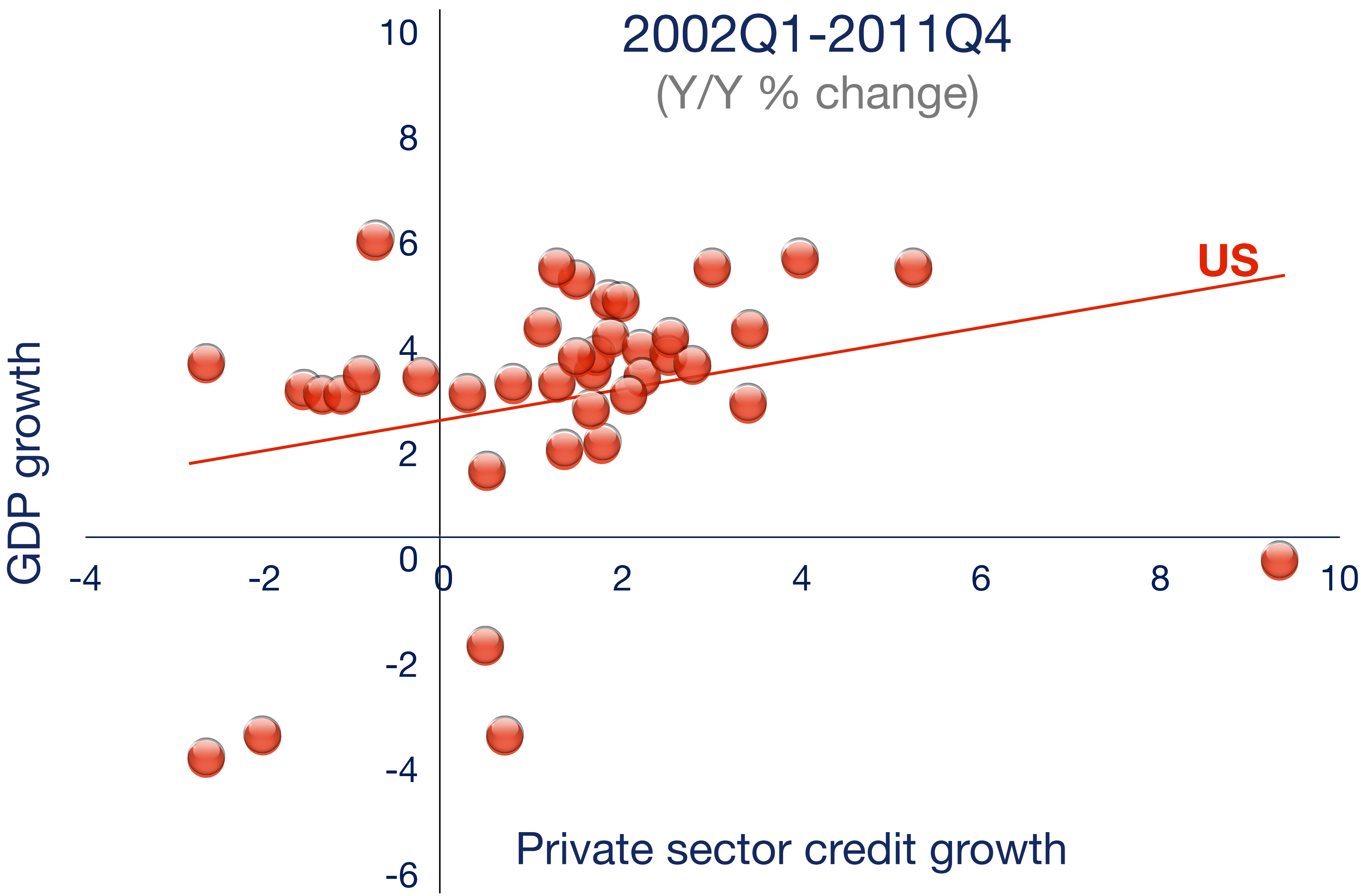
(billions of euros)



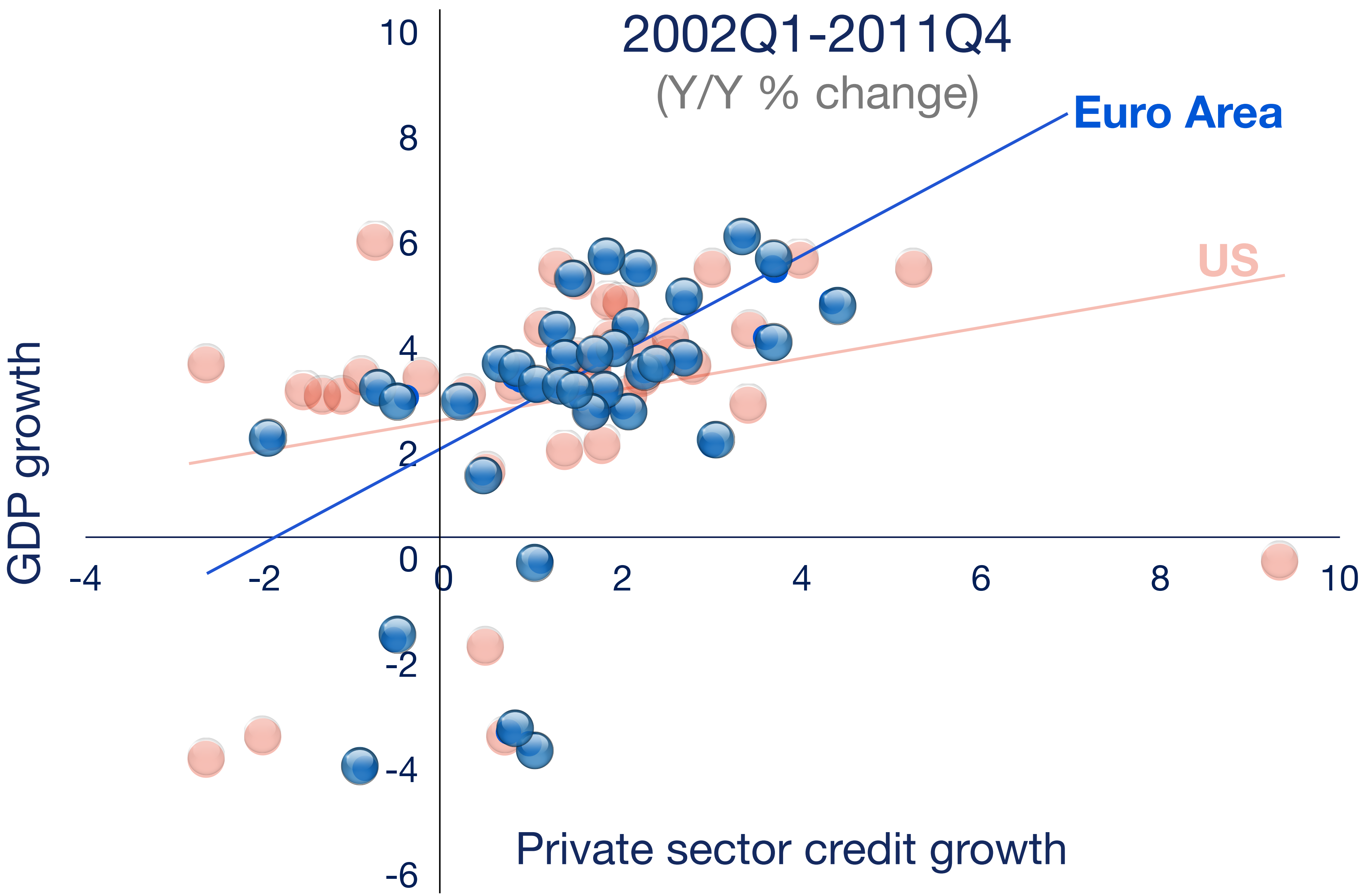
Diverging Lending Rates



Credit and GDP Growth

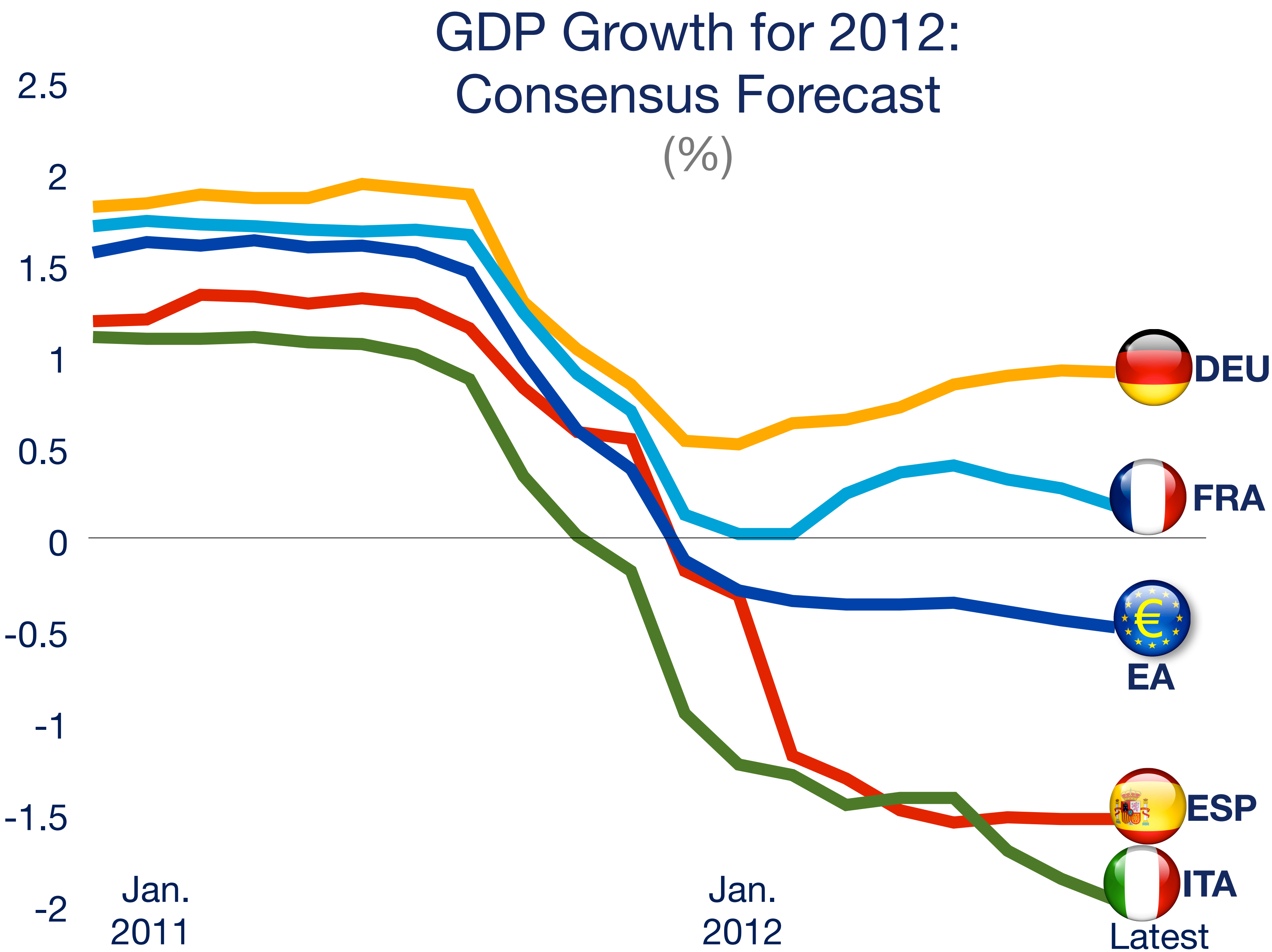


Credit and GDP Growth

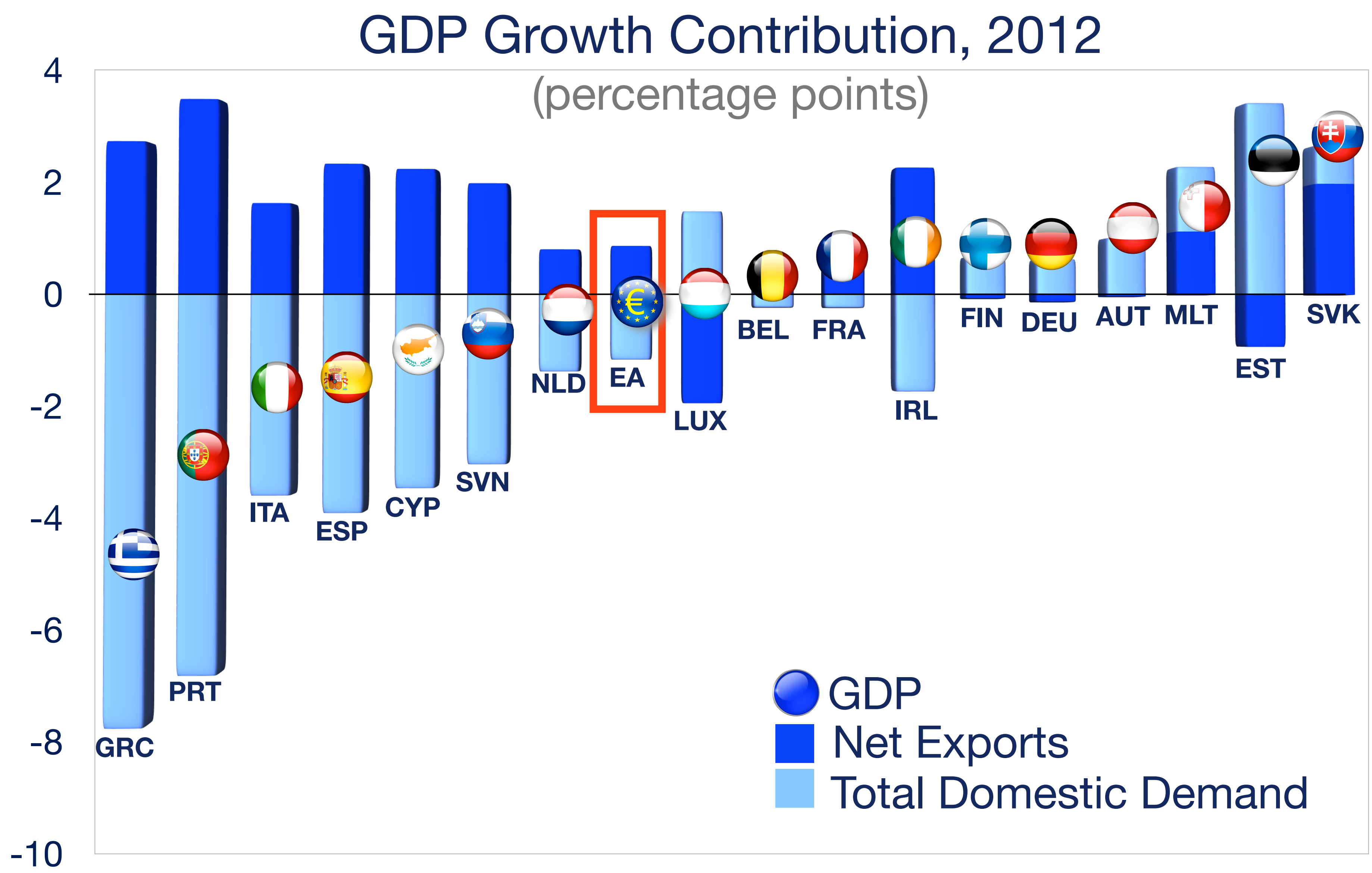


Euro Area Growth

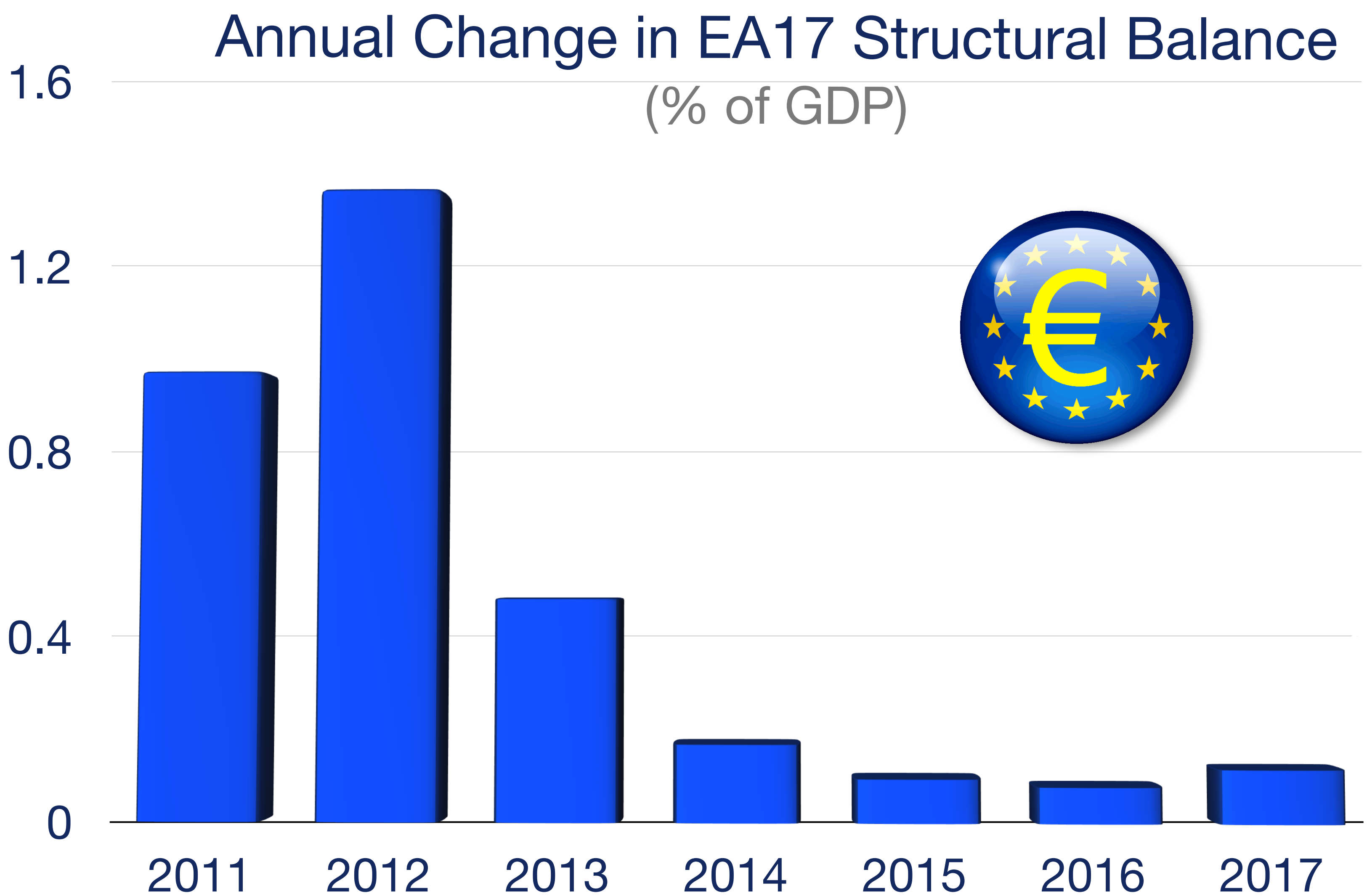
Outlook on Downward Path



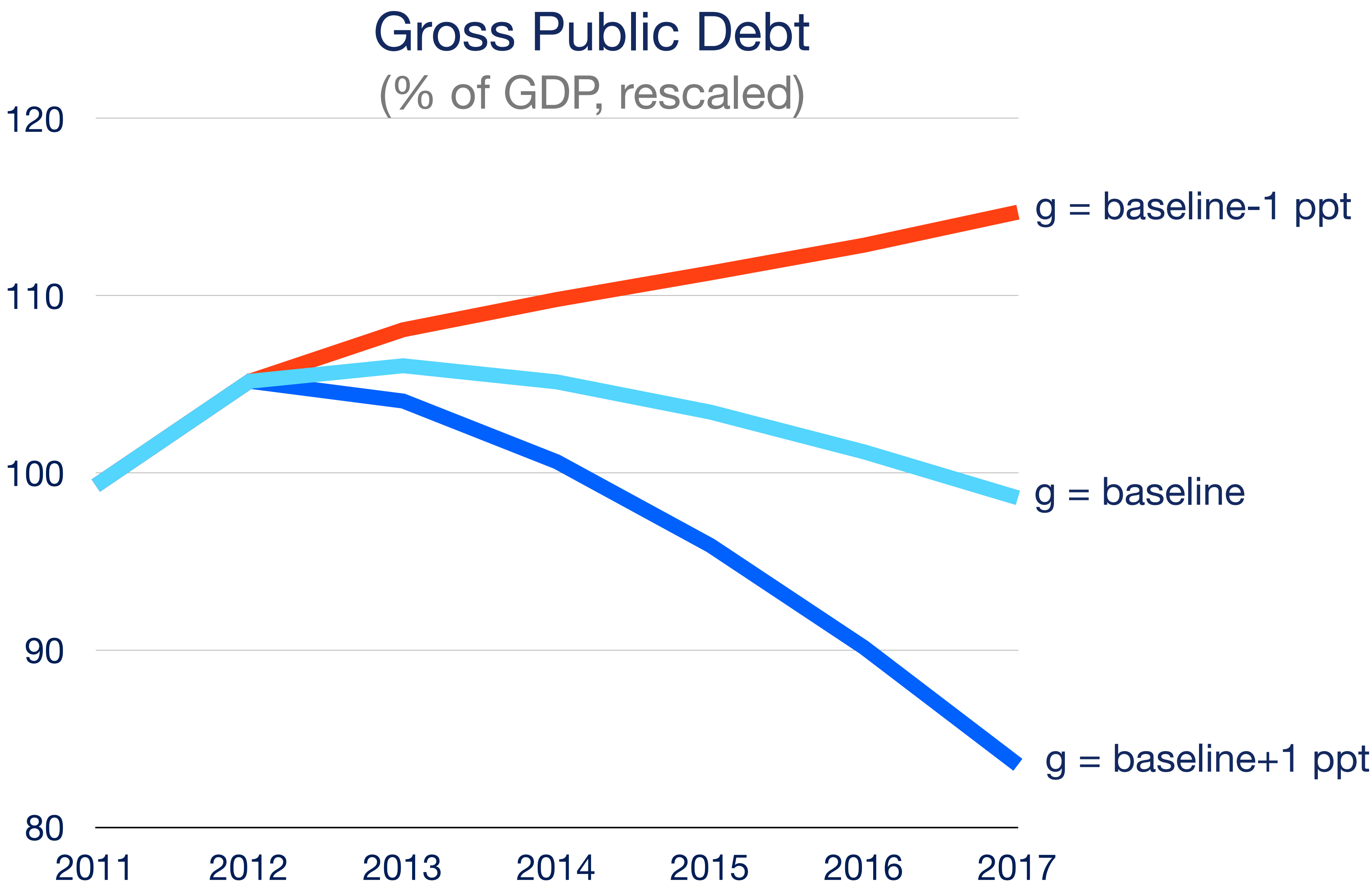
Domestic Demand Plunging in EA



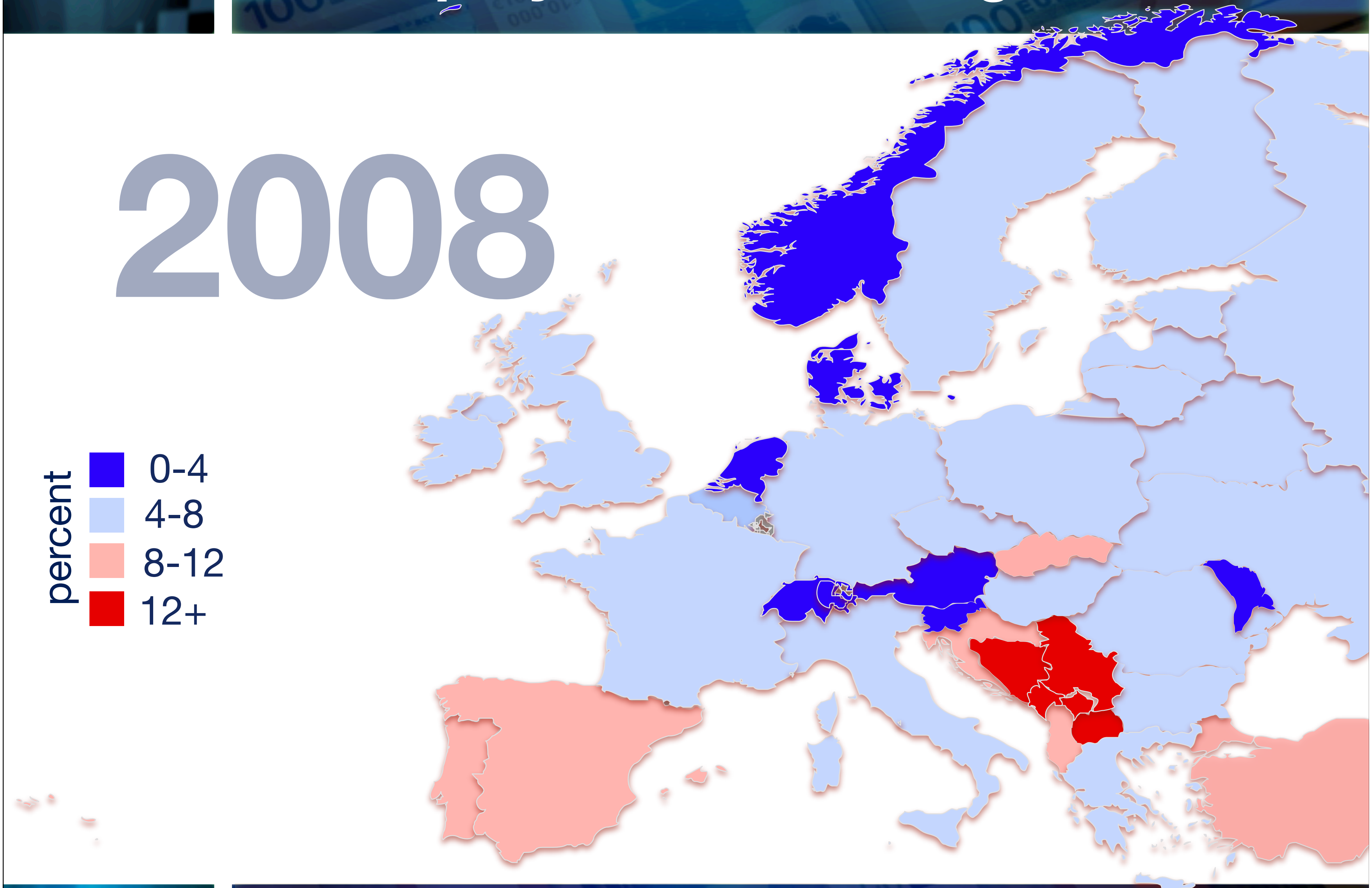
Front-Loaded Fiscal Effort



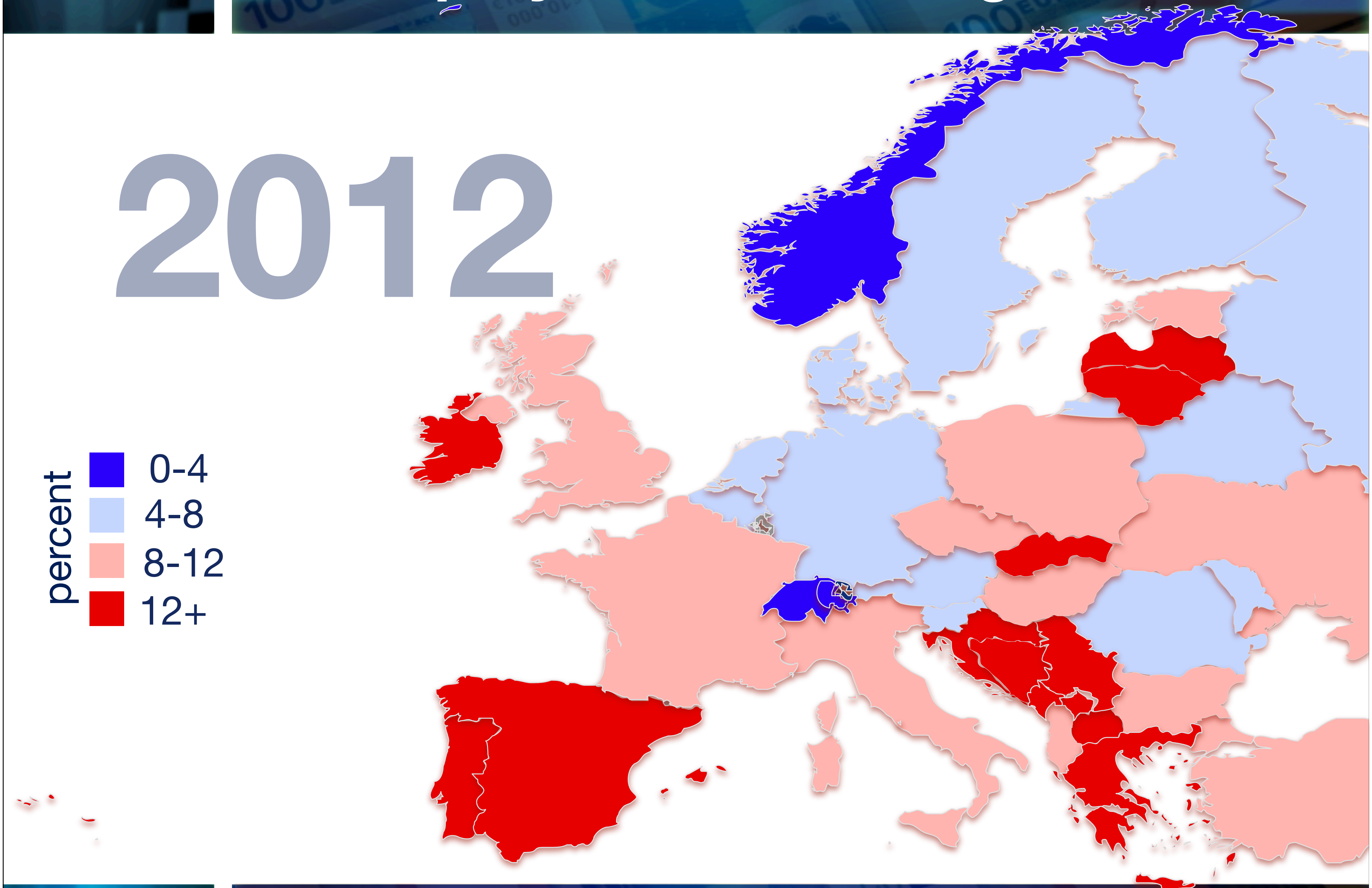
Growth Impacts Debt



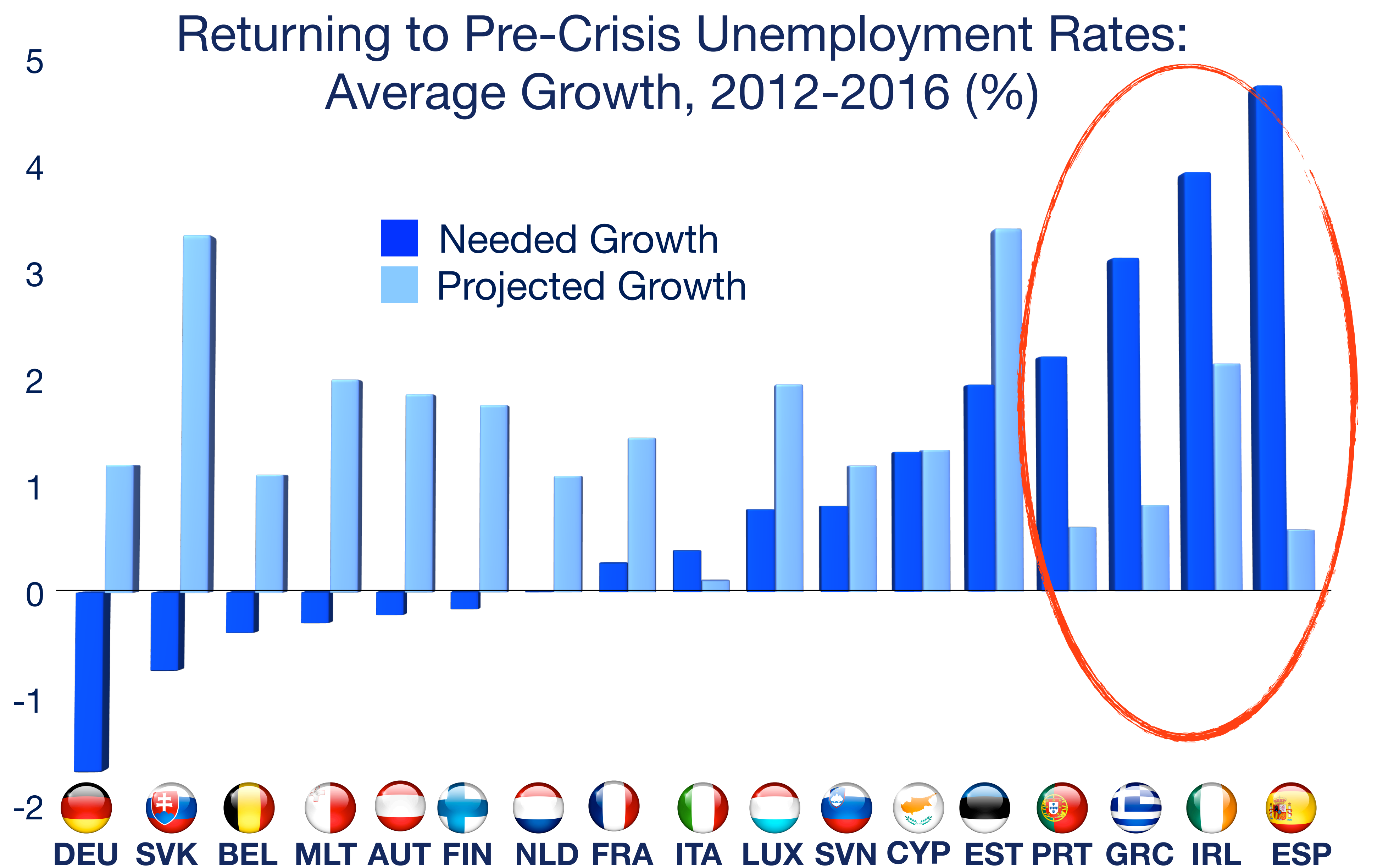
Unemployment Has Surged



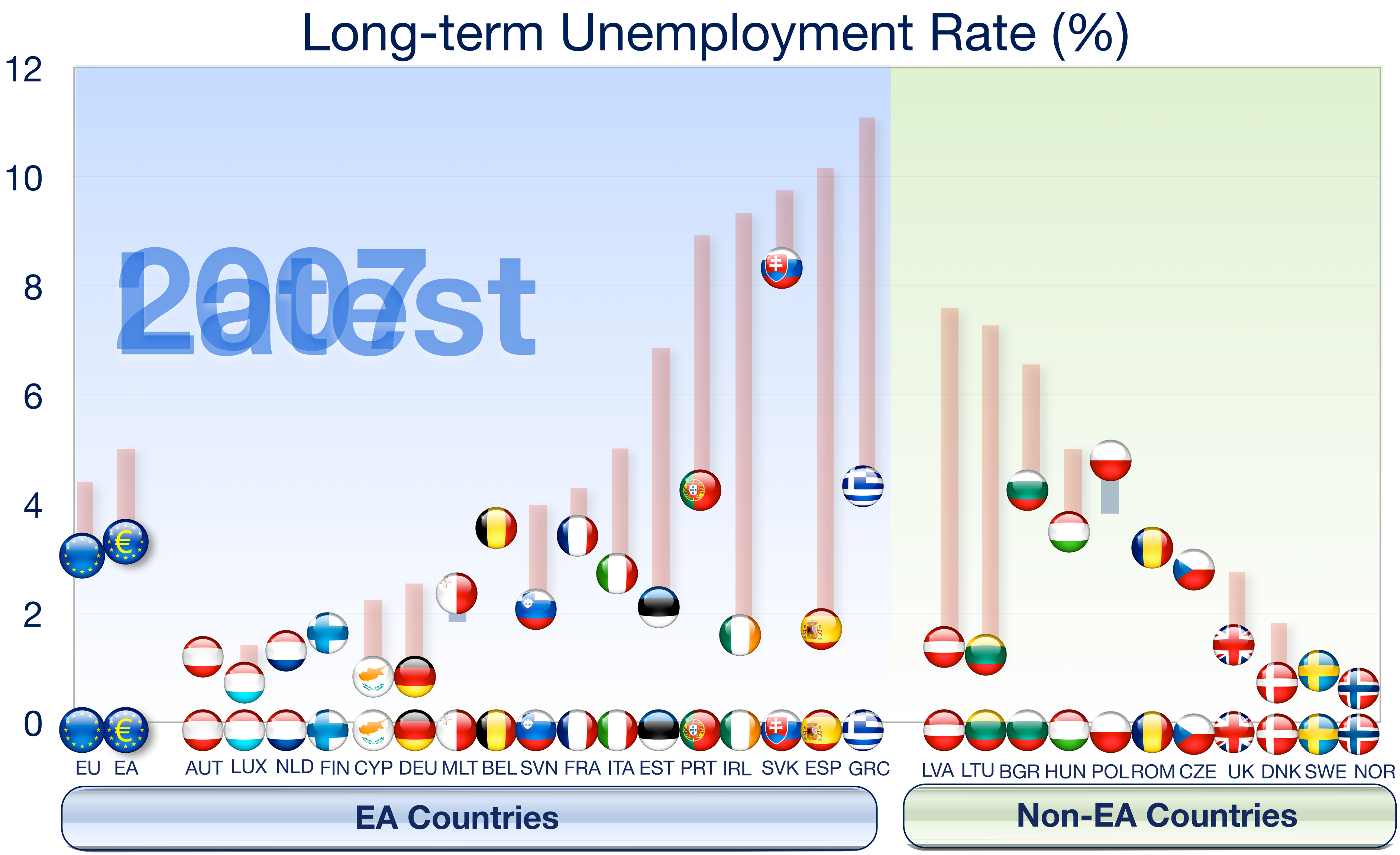
Unemployment Has Surged



Reducing Unemployment Not Easy



Potential Skills Loss



Euro Area Policies Architecture

Banking Union

Common Deposit Insurance

Common Resolution

Common Supervision

Single Rulebook

The Case for a Banking Union

- **Financial Stability national ➔ Fragmentation**
- **Uncertainty about banks ➔ Adverse growth effect**

Banking union

- Severs adverse feedback loop between banks and sovereign
- Provides incentive to end financial de-integration
- Helps restore monetary policy transmission

Elements of a Banking Union

- **Common deposit guarantee**
  - Reduces dependence of banks on their sovereign
  - Increases depositor confidence
- **Common bank resolution**
  - Authority to bail in private sector creditors
  - Facilitates orderly wind-down of failing institutions and deleveraging
- **Common supervision**
  - Foster stability
  - Deter fragmentation

Fiscal Union

Fiscal Compact/ Governance

Larger Central Budget

The Case for a Fiscal Union

- **Enhance adjustment to idiosyncratic shocks**

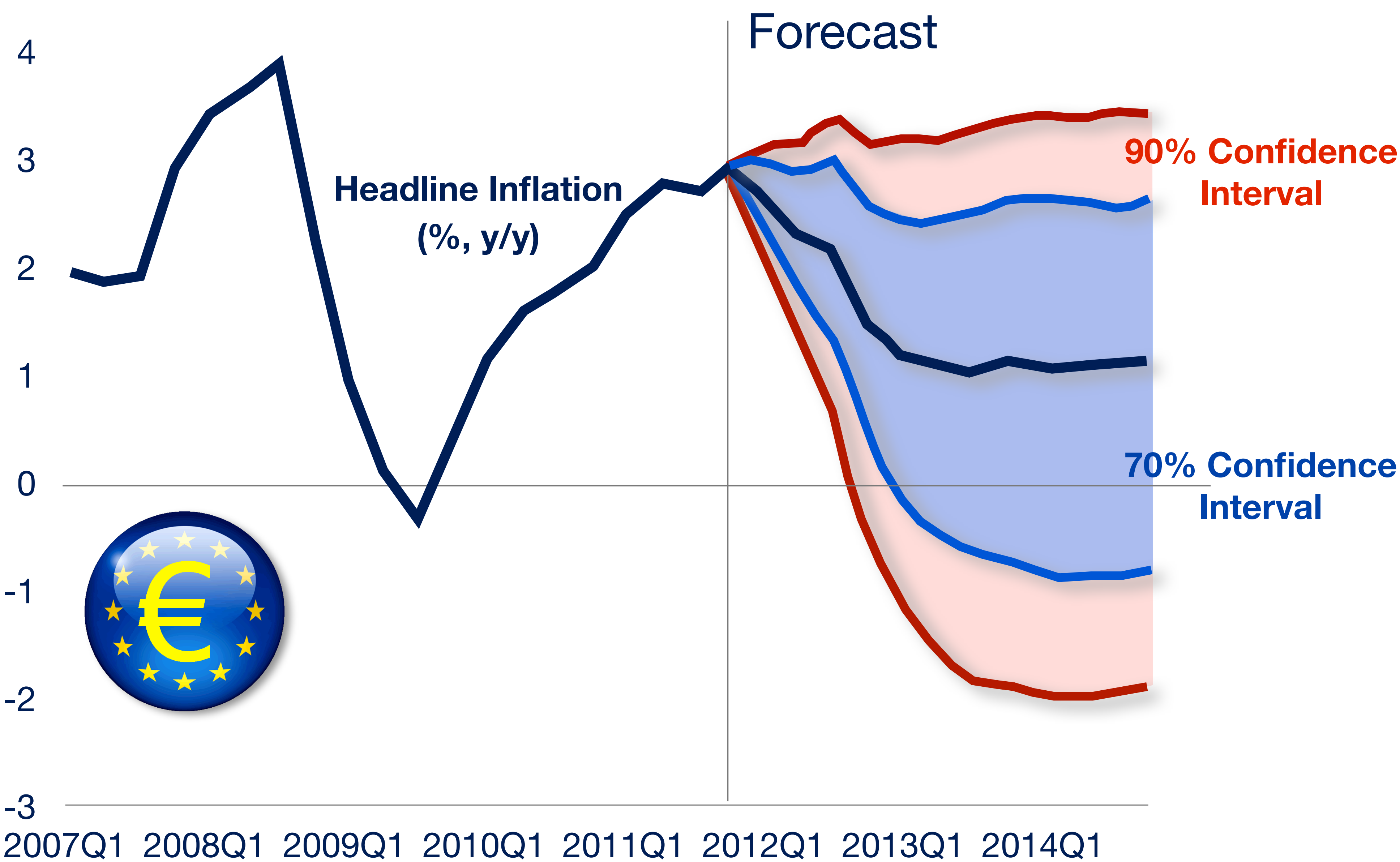
- **Deal with externalities and prevent contagion**

- **Reduce need for costly *ex-post* bailouts**
  - ***Financial stability***: area-wide back stop
  - ***Transfer and tax scheme***: provide insurance against idiosyncratic shocks
  - ***Public goods***: centrally provided, but region's relative tax contribution falls in downturn

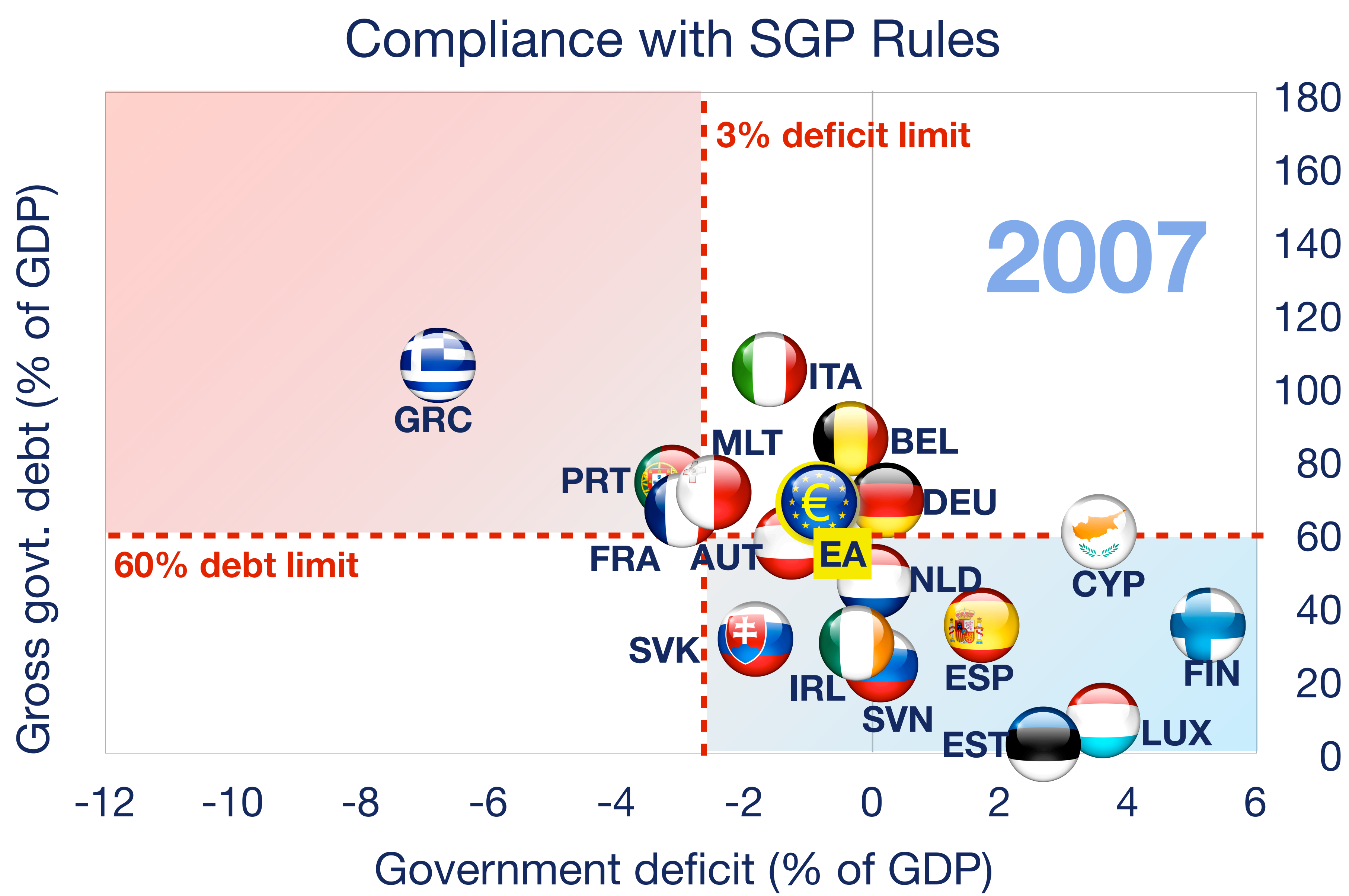
- **Need strong governance arrangements to address moral hazard**
  - Limit fiscal sovereignty
  - Ensure behavior in line with common standards

Euro Area Policies
Short-run Demand

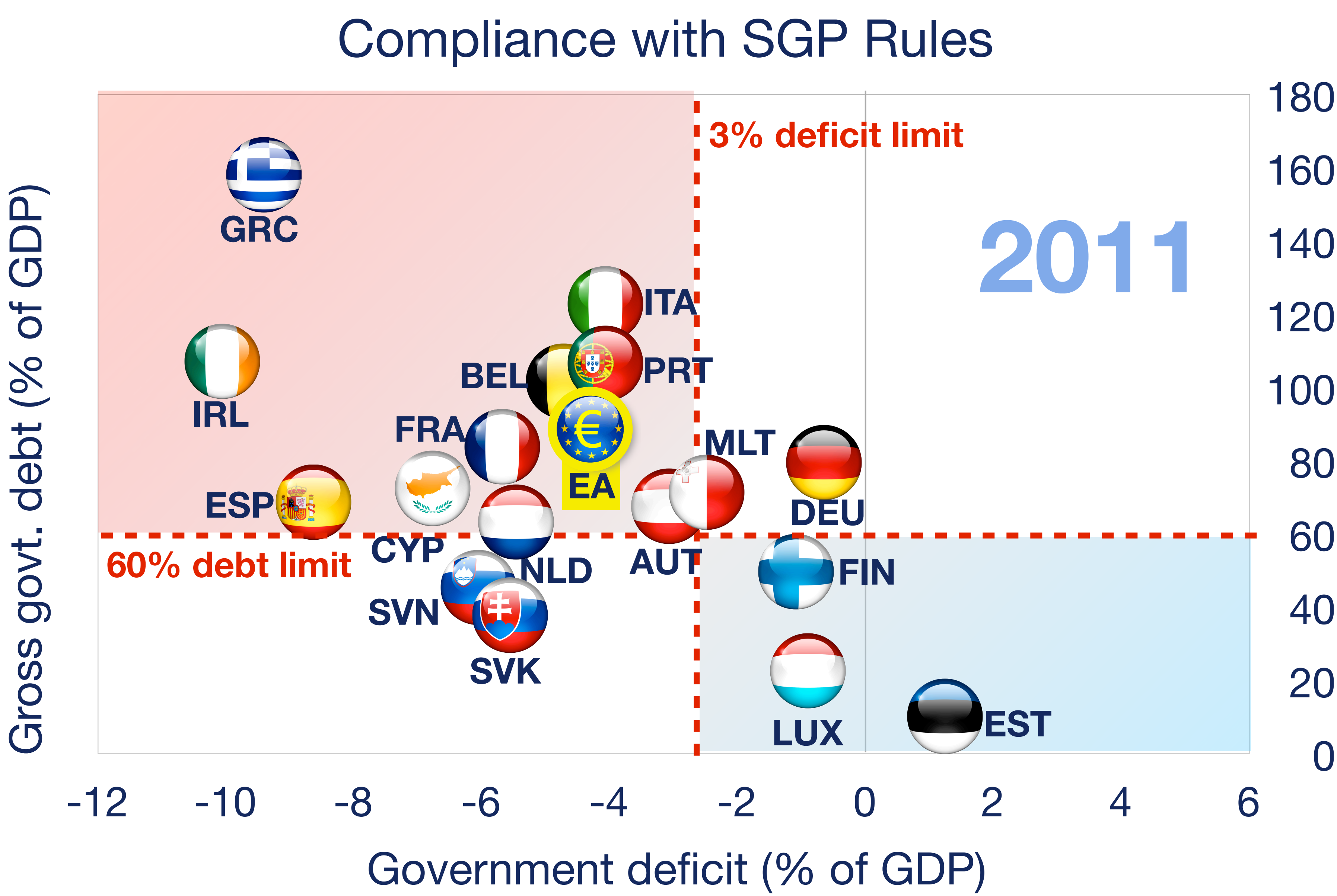
Inflation low and declining



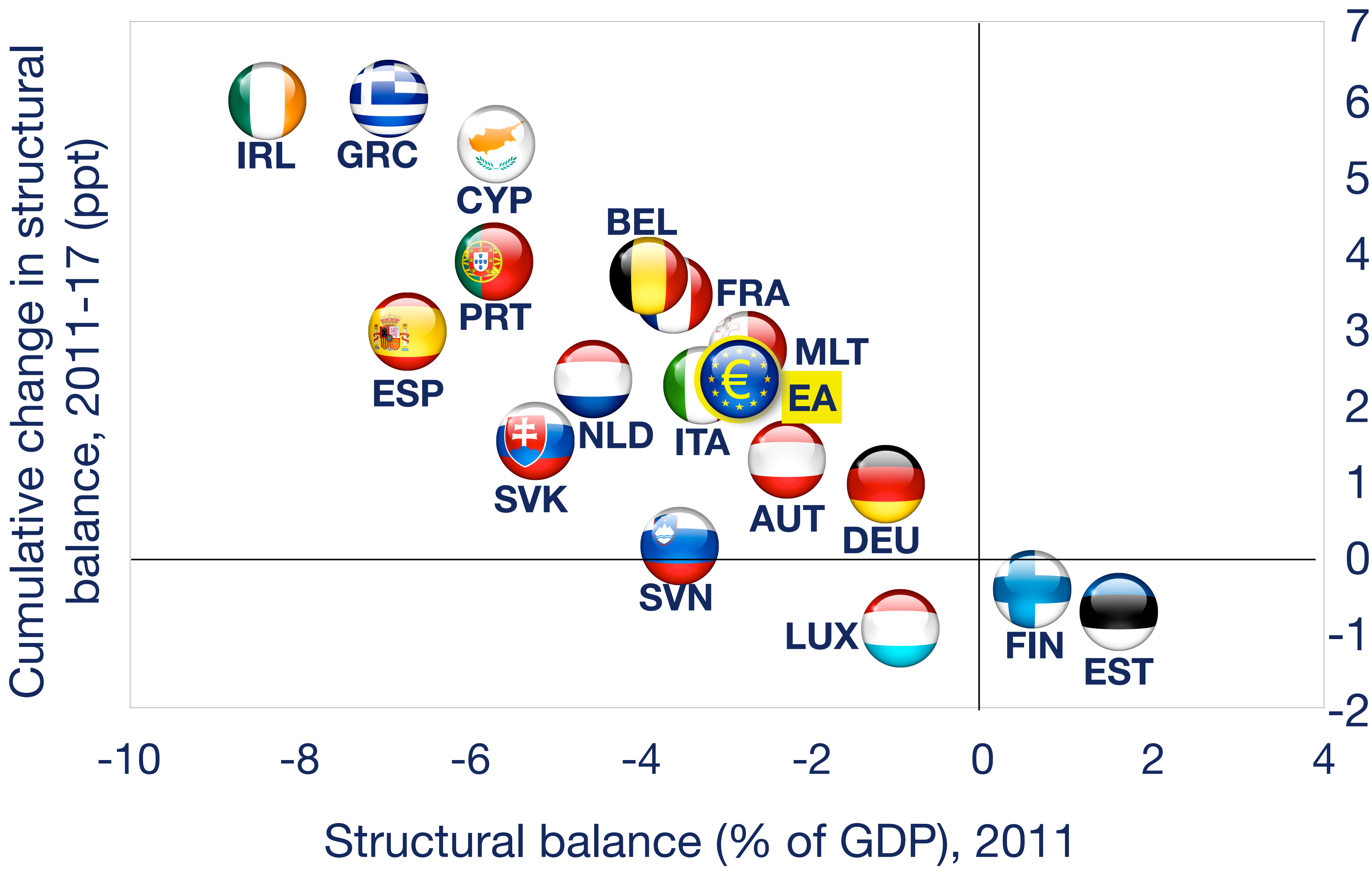
Maastricht Criteria



Maastricht Criteria

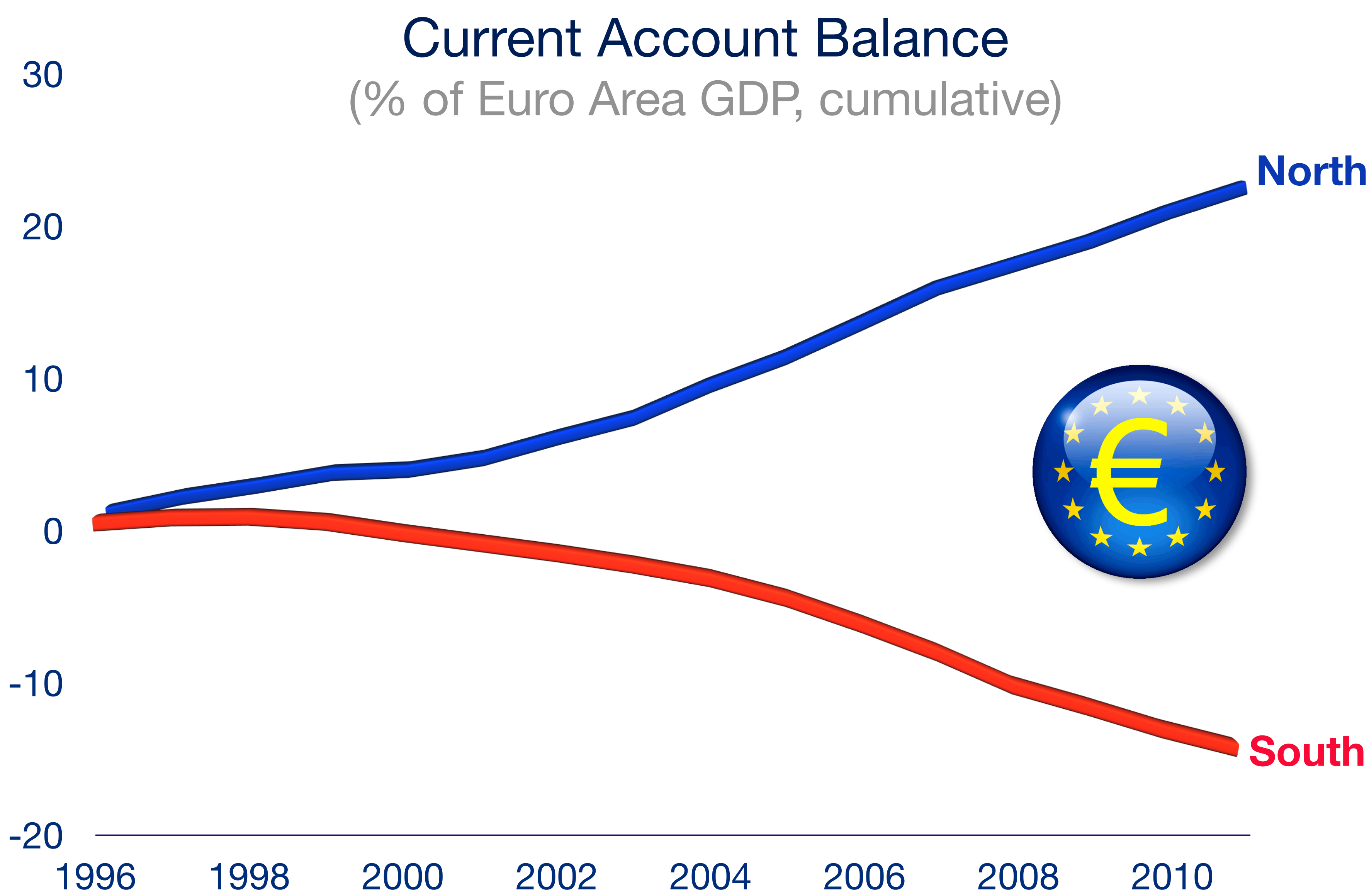


Ambitious Fiscal Effort

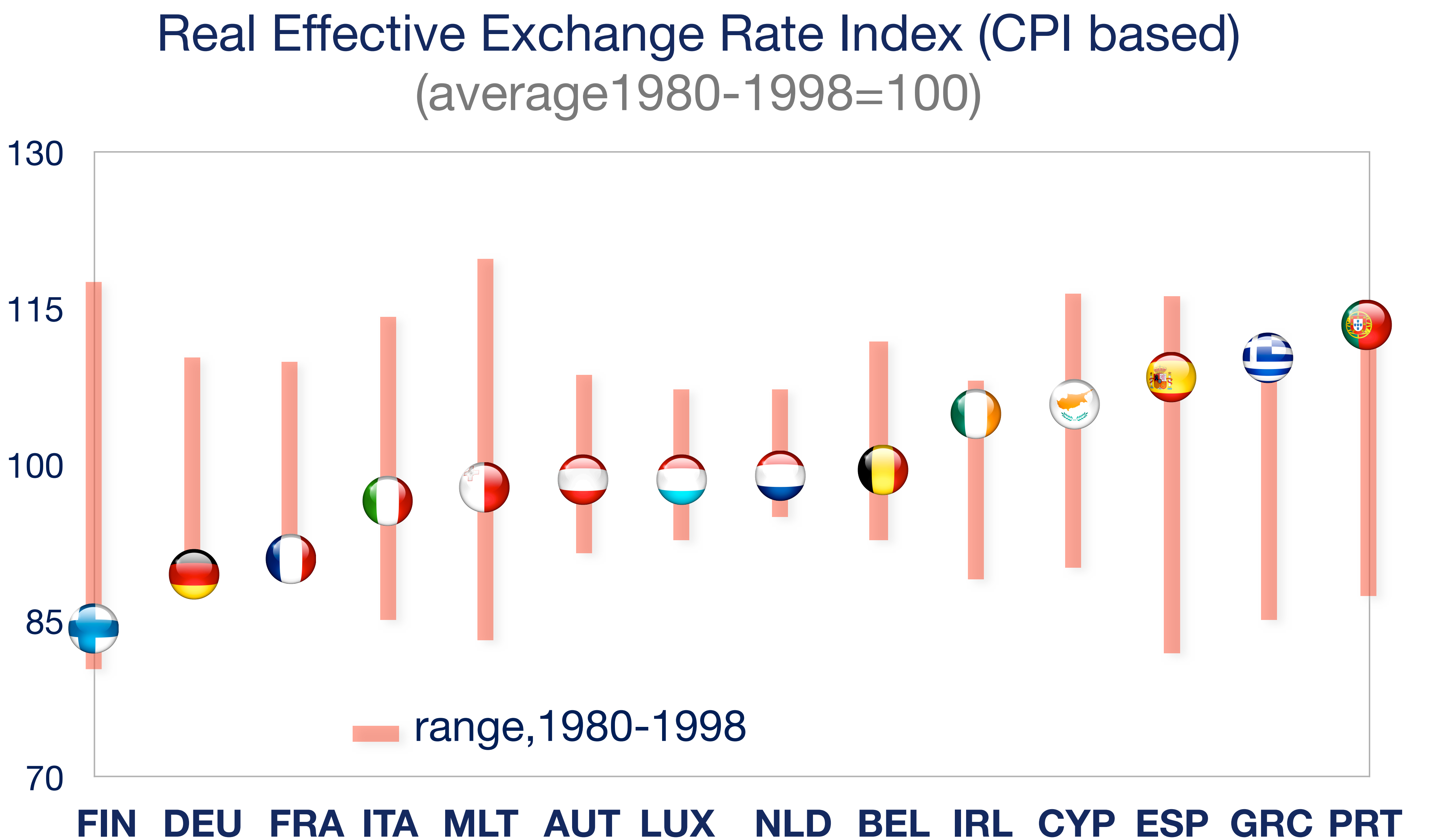


Euro Area Policies
Structural

Current Accounts Diverged



South: Competitiveness Gap



Conclusions

- Financial markets remain under stress
- Growth prospects are deteriorating
- Roadmap towards complete EMU can arrest decline in confidence
- Macroeconomic policy support needed in ST
- Structural reforms needed to address external imbalances

Thank you